

determination. This will stay the recovery of interest if the ruling is against the taxpayer. If the taxpayer prevails on the requested redetermination, it is entitled to receive repayment of his or her money with interest at the rate of 9% for the period during which those funds were on deposit. For reasons not explained, the County did not make such deposit. Under the statutory requirement the Circuit Court determined that the interest for the period in question is a proper charge in each of the above cases.

The taxpayer has appealed this decision.

HOMESTEAD CREDIT

Avis L. Blasch vs. Wisconsin Department Of Revenue (Wisconsin Tax Appeals Commission, October 15, 1982). On June 16, 1980 the department issued an income tax assessment against the taxpayer, disallowing the amounts of Homestead Credit issued to Avis Blasch in the years 1976, 1977, and 1978 on the grounds that by including the gross amount of Blasch's pension income in total household income in those years, Blasch's total income was over the allowable income levels for eligibility for homestead credit. On the original returns Avis Blasch filed for the years involved, she did not include in total household income on her Homestead Credit Claim, Schedule H, amounts she had received as a disability retiree under a Federal Civil Service pension.

Blasch filed amended returns for 1977 and 1978. For 1977 Blasch added to her Wisconsin total income \$1,681 representing her employer's

contribution to the gross amount of disability pension she received in that year. For 1978 she added to her Wisconsin total income \$5,445 representing the gross amount of disability pension, includable because she had attained age 65. Blasch did not claim homestead credit on these amended returns.

The Commission held in favor of the department. Section 71.09(7)(a)1, Wis. Stats., provides that the term "income" for purposes of homestead credit includes "the gross amount of any pension of annuity." The gross amount of disability pension payments received by Avis Blasch in the years at issue should have been included in her total household income. Blasch's total household income was over the limit for each of the years at issue and, therefore, she was not entitled to homestead credit for the years at issue.

The taxpayer has not appealed this decision.

TAX RELEASES

("Tax Releases" are designed to provide answers to the specific tax questions covered, based on the facts indicated. However, the answer may not apply to all questions of a similar nature. In situations where the facts vary from those given herein, it is recommended that advice be sought from the Department. Unless otherwise indicated, Tax Releases apply for all periods open to adjustment. All references to section numbers are to the Wisconsin Statutes unless otherwise noted.)

INDIVIDUAL INCOME TAXES

1. Treatment for Capital Gain Portion of a Lump-Sum Distribution from a Retirement Plan or Profit Sharing Plan

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1. Interstate Telephone Service
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INDIVIDUAL INCOME TAXES

1. Treatment for capital gain portion of a lump-sum distribution from a retirement plan or profit sharing plan

Facts and Question: A taxpayer receives a lump-sum distribution from a qualified retirement plan. Under the provisions of the Internal Revenue Code (IRC) the taxable part of this distribution is divided into two parts (1) income taxable as a long-term capital gain, and (2) income taxable as ordinary income. For purposes of computing federal income tax under a special 10-year averaging method, sec-

tion 402(e)(4)(L) of the IRC permits a taxpayer to elect to treat the entire taxable part of a lump-sum distribution as ordinary income. When this election is made, the entire taxable portion of the lump-sum distribution is computed on Form 4972. The tax payable on the lump-sum distribution is computed on Form 4972 and then the amount of tax is transferred to line 39 of a federal 1982 Form 1040.

Section 71.05(1)(a)8 of the Wisconsin Statutes provides that any portion of a lump-sum distribution which is excluded from federal adjusted gross income under section 402(e) of the IRC must be added back for purposes of determining a taxpayer's Wisconsin taxable income.

If the amount of lump-sum distribution excluded from federal adjusted gross income is added back (pursuant to s. 71.05(1)(a)8) to determine Wisconsin taxable income, does the portion of the distribution which is identified as capital gain income retain its character for purposes of qualifying for the capital gain exclusion in s. 71.05(1)(a)2, Wis. Stats.?

Answer: Yes. Even though a taxpayer has elected for federal income tax purposes to treat the capital gain portion of a lump-sum retirement plan distribution as ordinary income in computing tax under the federal 10-year averaging method, a different election may be made for Wisconsin purposes. Wisconsin law does not allow the use of the 10-year averaging method of computing tax provided by section 402(e) of the IRC. Therefore, for Wisconsin purposes there is no tax advantage to treating the capital gain portion of a lump-sum distribution as ordinary income.

The manner in which the federal-Wisconsin difference in the treatment of a lump-sum distribution should be accounted for on the Wisconsin return depends on whether or not the taxpayer has other capital gain and loss income

for such year. The proper reporting on the Wisconsin return is as follows:

1. Taxpayer has no capital gain or loss income other than the lump-sum distribution. In computing the amount to enter as an addition to federal income on line 30 of Wisconsin Form 1 (to include in Wisconsin income the lump-sum distribution income reported on federal Form 4972), the appropriate percentage of the capital gain portion of such distribution may be excluded. For the 1982 taxable year the capital gain exclusion percentage for Wisconsin is 20%, for 1983 it is 40% and in 1984 and thereafter it will be 60%.

Example: Taxpayer receives a lump-sum distribution totaling \$20,000 during 1982. The full amount of the distribution represents taxable income with \$8,000 classified as capital gain income and \$12,000 as ordinary income. For federal income tax purposes, the tax on this income is computed by using the 10-year averaging method and an election is made to treat the entire distribution as ordinary income. For Wisconsin the taxpayer does not elect to treat the entire distribution as ordinary income. Rather, the taxpayer wants to report the \$12,000 as ordinary income and \$8,000 as capital gain income on the Wisconsin return. No other capital gains or losses are reportable for 1982.

On line 30 of a 1982 Wisconsin Form 1, the taxpayer would enter \$18,400, computed as follows:

\$ 8,000	Capital gain portion of lump-sum distribution
<u>(1,600)</u>	Capital gain exclusion allowable for 1982 on Wisconsin return (\$8,000 x 20% = \$1,600)
\$ 6,400	Net amount of capital gain portion taxable by Wisconsin
<u>12,000</u>	Ordinary income portion of lump-sum distribution
<u>\$18,400</u>	Total to be entered on line 30, Form 1 as an addition to federal income

A schedule showing how the amount entered on line 30 of Form 1 was calculated should be included with the Form 1 filed.

2. Taxpayer has capital gains or losses other than the lump-sum distribution. A revised federal Schedule D should be prepared to determine the amount of capital gain or loss which is reportable on line 11 of the Wisconsin Form 1 as capital gain or loss. The amount calculated on the revised Schedule D will also affect the amount of capital gain deduction which is required to be added to Wisconsin income on line 27 of Form 1.

Example: Assume the same facts as in the above example, except that the taxpayer also has a short-term capital loss incurred in 1982 of \$5,000 and the taxpayer is married. The amounts which would be reportable on lines 11, 27 and 30 in Column B of Form 1 would be determined as follows:

\$ 8,000	Capital gain portion of lump-sum distribution
<u>(5,000)</u>	Capital loss incurred in 1982
\$ 3,000*	Net gain reportable on revised Schedule D
<u>(1,800)</u>	60% federal exclusion
\$ 1,200*	Amount of gain reportable on line 11 Form 1
1,200*	Amount reportable on line 27, Form 1 as an add-back for capital gains (2/3 of \$1,800 federal exclusion)
<u>12,000</u>	Ordinary income portion of lump-sum distribution reportable on line 30, Form 1 as an addition to federal income
<u>\$14,400</u>	Total amount of lump-sum distribution includable in Wisconsin taxable income for 1982

*Wisconsin taxes 80% of long-term capital gains for 1982. Therefore, \$2,400 (80% of \$3,000) of the gain is taxable for Wisconsin. The \$2,400 is reported on the Wisconsin return by entering \$1,200 on line 11, Form 1 and \$1,200 on line 27, Form 1.

The revised Schedule D, which shows how the amounts entered on lines 11 and 27 of Form 1 were calculated, should be included with the Form 1 filed.

FRANCHISE TAXES

1. Wisconsin Corporate Tax Treatment Of Foreign Dividend Gross-Up

Under section 902(a) of the Internal Revenue Code (IRC), a U.S. domestic corporation which receives a dividend from a foreign corporation in which it owns 10% or more of the voting stock may elect to take credit for the foreign tax levied upon the foreign subsidiary's accumulated profits that are the basis of the dividend received. The domestic company is deemed to have paid a share of the foreign tax based on the proportion that the dividends received bears to net earnings of the foreign subsidiary. Under section 78 of the IRC, taxes deemed paid must be included in federal taxable income if the tax credit is claimed. This is referred to as "Foreign Dividend Gross-Up".

For Wisconsin franchise/income tax purposes, since the credit is not permitted and the gross-up is income created under the Internal Revenue Code, the gross-up is not properly includable in the computation of Wisconsin net income. (Note: The U.S. Supreme Court, in its June 20, 1982 decision in F.W. Woolworth Co. v. Taxation and Revenue Department of the State of New Mexico (73L Ed 2nd 819), held that New Mexico's efforts to tax the "gross-up" income contravenes the Due Process Clause.)

Example: Throughout 1982, domestic corporation D owns all the stock of foreign corporation F. Both corporations use the calendar year as the taxable year. Corporation F has accumulated profits, pays foreign income taxes, and pays dividends for 1982 as summarized below. For 1982, corporation D is deemed to have paid \$20 of foreign income taxes paid by corporation F for 1982 and includes such amount in federal gross income under section 78 as a dividend, determined as follows:

Gains, profits and income of F Corporation	\$100
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Foreign income taxes imposed on or with respect to gains, profits and income.....	40
Accumulated profits.....	100
Foreign income taxes paid on or with respect to accumulated profits (total foreign income taxes)	40
Accumulated profits in excess of foreign income taxes.....	60
Dividends paid to D Corporation	30
Foreign income taxes of F Corporation deemed paid by D Corporation under sec. 902(a) (\$40 x \$30/\$60)	20

This \$20 deemed paid tax (sec. 78 gross-up) is required to be included in federal taxable income when a foreign tax credit is claimed. The \$20 will appear on federal Schedule M-1 as an addition to income. For Wisconsin franchise/income tax purposes, this federal Schedule M-1 add-adjustment should be reversed and not be included in Wisconsin net income.

2. Does a Certificate of Authority Create Wisconsin Nexus?

Facts and Question: Section 180.801, Wis. Stats., requires a foreign corporation to procure a Certificate of Authority from the Secretary of State before it transacts business in Wisconsin. Wis. Adm. Code section Tax 2.82(2) requires a "licensed" foreign corporation to file a franchise/income tax return.

Foreign Corporation X manufactures property in Illinois, some of which it ships to Wisconsin customers by common carrier to fill orders received by telephone or mail at the Illinois sales office. Corporation X obtains a Wisconsin Certificate of Authority, but has no Wisconsin property or payroll, or other connection with Wisconsin except these destination sales.

Does Corporation X include in the numerator of its Wisconsin sales factor the above described destination sales?

Answer: No. Wisconsin destination sales are not included if Corporation X transacts no other business in Wisconsin, because of the protection of Public Law 86-272. Instead of filing a complete Wisconsin franchise/income tax return, Corporation X may file its annual returns (Form 4 or Form 5) stating only "No business transacted in Wisconsin". Because Corporation X does transact business outside Wisconsin it may not file a Declaration of Inactivity (Form 4H).

3. Effect of Certificate of Authority on Apportionment

Facts: Section 71.07(2)(c)2, Wis. Stats., provides: "Sales of tangible personal property are in this state if . . . the property is shipped from an office, store, warehouse, factory or other place of storage in this state and the purchaser is the United States government or the taxpayer is not within the jurisdiction, for income tax purposes of the destination state." Wis. Adm. Code section Tax 2.39(2) provides: "In order to use the apportionment method the taxpayer must have income from business activity subject to taxation by this state and at least one other state or foreign country."

Section 71.07(2)(c)1, Wis. Stats., provides that the numerator of the sales factor includes sales to customers in this state "plus 50% of the sales deemed to be in this state because the taxpayer is not within the jurisdiction of the destination state for income tax purposes".

Question 1: Corporation Y manufactures property in Wisconsin, some of which it ships to Minnesota customers by common carrier to fill orders received by telephone or mail at the Wisconsin sales office. Corporation Y obtains a Minnesota Certificate of Authority, but has no payroll or property outside of Wisconsin, or other connection with Minnesota except these destination sales. May Corporation Y apportion less than 100% if its income to Wisconsin?

Answer 1: Corporation Y may not apportion its income, but must report 100% to Wisconsin because it does not have business activities subject to taxation by Minnesota. Corporation Y is not taxable in Minnesota if it just has a Minnesota Certificate of Authority, destination sales, and no other business activity. (Kelvinator Commercial Products, Inc. vs. Wisconsin Department of Revenue, WTAC March 10, 1981).

Question 2: Corporation Z manufactures property in Wisconsin, some of which it mails to customers in Michigan, Minnesota and Iowa. Corporation Z obtains Certificates of Authority in both Minnesota and Iowa. It has no payroll or property in Michigan or Iowa, but it maintains an office in Minnesota. How are destination sales into Michigan, Iowa, and Minnesota reported in Corporation Z's Wisconsin franchise/income tax return?

Answer 2: Corporation Z may file its Wisconsin returns on the apportionment method, excluding Minnesota sales, payroll and property from the numerators of its apportionment factors because the office there gives Minnesota jurisdiction to tax. Although it has a Certificate of Authority in Iowa, 50% of both Iowa and Michigan sales are "thrown-back" to the Wisconsin numerator because Corporation Z has no other business activities in either state.

SALES/USE TAXES

1. Interstate Telephone Service

Facts and Questions: Chapter 317, Laws of 1981, effective May 1, 1982 imposed the 5% sales tax on interstate telephone services originating from and charged to a telephone located in this state. Several types of telephone services are provided across state lines including the following:

- In-Wats** This Wide Area Telephone Service coming into Wisconsin from out-of-state is a switched message telephone service using a dedicated access line between a customer's premises and the telephone company exchange.
- Out-Wats** This involves providing an access line between the customer's premises and a telephone company exchange. These calls originate in Wisconsin and terminate out-of-state.
- Tie Line, FX (Foreign Exchange) and Private Line Service** A Tie line is a single or multiple line dedicated to a single user connecting 2 switching systems. FX service is a direct line from a distant exchange to a local exchange which is set aside for the use of one customer. Private line service is dedicated to the use of a single customer. For example, a private line may connect a manufacturer's plant in Wisconsin with another plant located in a neighboring state. All of these private line services are billed in advance according to the mileage involved, not based on usage of the line. There is no accurate means of determining the origin of any of the

telephone messages transmitted on any of these circuits dedicated to the use of a single customer.

Are in-Wats, out-Wats and private line services which involve telephone messages in interstate commerce subject to the sales tax?

Answer: In-Wats service which originates in another state is not a service subject to the sales tax under the imposition language in s. 77.52(2)(a)4, Wis. Stats. However, the gross receipts from providing out-Wats interstate telephone service, which originates in this state, are taxable, effective May 1, 1982.

The gross receipts from interstate tie line, FX and other private line services, which consist of a circuit or circuits dedicated to the use of customer are not taxable under s. 77.52(2)(a)4, Wis. Stats.

2. New 12% U.S. Retail Excise Tax on Heavy Trucks and Trailers

Facts and Question: Effective April 1, 1983 the federal manufacturer's excise tax on trucks and trailers was repealed and replaced by a new 12% federal excise tax imposed on the first retail sale of heavy trucks and trailers. See 26 USC 4051.

Question: Is the new 12% federal excise tax on heavy trucks and trailers includable in either the gross receipts or sales price which is the measure of the Wisconsin sales or use tax?

Answer: The new 12% federal excise tax is imposed upon the retail sale and is measured by a stated percentage of the amount for which the article is sold. Therefore, under ss. 77.51(11)(a)4a and 77.51(12)(a)4, Wis. Stats., and Rule Tax 11.26(3)(b) the retailer's 12% U.S. excise tax is not includable in taxable gross receipts or sales price for Wisconsin sales or use tax purposes, because Wisconsin law specifically excludes any federal tax "measured by a stated percentage of sales price or gross receipts."

3. Burglar And Fire Alarm Systems

Facts and Question: Burglar and fire alarm systems are usually sold or leased. They are connected with the electrical system that is within the walls of the building. Installation requires cutting holes in the walls to place metal sleeves and metal encased wiring along and through the walls and fastening sensors and other alarm devices to the walls and ceilings. There are some systems which are directly connected to a local police station or fire department station. Other alarm systems are directly connected to a central monitoring station maintained by a private party who provides a protection service. Three types of systems, designated as A, B and C, are as follows:

a) The "local" (private) alarm system is a self-contained system within a building which sounds a bell or other alarm on the customer's premises only when an unau-

thorized entry is made on the premises or a fire is detected. This system is not connected to a central monitoring system and the person installing the burglar or fire alarm fixtures does not provide any "protection service" subsequent to the installation.

- b) The "direct connect" alarm system is also a self-contained system installed on a customer's premises, which is connected by telephone wire to either a local police or fire station where the alarm sounds. These "direct connect" systems are similar to the local alarm systems in that the person installing the system does not provide any "protection service" subsequent to the installation.
- c) A "central station" alarm system is a system which is installed on a customer's premises and connected to a central monitoring station maintained by the person providing the protection service. When there is an unauthorized entry or fire, a signal is received at the central station and the person providing the protection service notifies the police or fire department and/or dispatches some of its own armed guards or employees to the customer's premises.

The question is whether the sale and installation of each type of system is subject to the sales or use tax and whether the gross receipts from providing a protection service are taxable.

Answers:

- a) The *sale* and installation of a local alarm system is considered a real property improvement activity under the 3 criteria standard established by the Wisconsin Supreme Court in the *A.O. Smith Harvestore Products, Inc.* decision (72 Wis. 2d 60). The seller-installer is deemed the consumer of all tangible personal property used in such activity and the tax applies to its purchases of materials, fixtures, etc. However, burglar and fire alarm fixtures retain their identity as tangible personal property (s. 77.52(2)(a)10, Wisconsin Statutes) after installation and the gross receipts derived from the repair, service, and maintenance of such fixtures are taxable. The gross receipts received from the *lease* and installation of a local alarm system are subject to the tax, if the lessor has the right of removal at the expiration or breach of the lease.
- b) The sale and installation or lease and installation of a direct connect alarm system are treated the same as the local alarm system in "A" above.
- c) The person providing the protection service is the consumer of all the materials and equipment used in the system and the tax applies to service provider's purchases of such equipment and materials. The gross receipts received from providing this protection service are not taxable.